STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: April 27, 2006

To: The Commission
(Meeting of April 27, 2006)

From: Delaney Hunter, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: **SB 1794 (Dunn) – PUC: regulation of refineries.**
As Amended April 18, 2006

LEGISLATIVE SUBCOMMITTEE RECOMMENDATION: Oppose

SUMMARY OF BILL:

This bill would require the California Public Utilities Commission (CPUC) to establish an entirely new division for the regulation and oversight of oil refineries, while explicitly precluding the CPUC from establishing rates for refinery products.

SUMMARY OF SUPPORTING ARGUMENTS FOR RECOMMENDATION:

The CPUC's regulatory plate is already full to overflowing. While state regulation of oil refineries may or may not be good public policy, the CPUC is opposed to assuming responsibility for yet another major and complex industry in addition to its current authority over energy utilities, telecommunications companies, water utilities, household goods carriers, passenger carriers, and rail. The Legislature should be encouraged to task another state agency with refinery regulation or to create a new state agency for this purpose.

SUMMARY OF SUGGESTED AMENDMENTS (if any):

None.

DIVISION ANALYSIS (OGA):

- According to the California Energy Commission:
  - There are currently 21 oil refineries operating in California with processing capacity ranging from 2,800 to 260,000 barrels of crude oil a day.
  - Most of these refineries are located in the San Francisco Bay area, Los Angeles area, and the Central Valley.
  - From 1985 to 1995, 10 California refineries closed, resulting in a 20 percent reduction of refining capacity.
  - Further refinery closures are expected for small refineries with capacities of less than 50,000 barrels a day, and it is unlikely that any new refineries will be built, due to the cost of complying with environmental and other state regulations.

- Due to the small number of refineries in California and the convergence of several factors that make California an isolated market, demand and supply remains tight. The tight margin leads to gasoline price spikes and increased oil company profits when refinery output declines due to mechanical failures and scheduled maintenance. Arguably, there is no economic incentive for oil companies to prevent refinery outages or to build new and more efficient refineries because a surplus would force down prices and lower their profits.

- Based on the experience of Electric Generation Performance Branch (EGPB), the Commission would need to initiate a proceeding for the establishment of the scope of the CPUC's regulatory authority, the implementation of regulations and standards, as well as other necessary administrative steps, for the regulation of refineries.

- The new refinery division would most likely:

  - implement and enforce the regulations and standards established by the Commission for the maintenance and operation of refineries so as to protect California residents and businesses;

  - perform operation and maintenance audits, outage inspections and investigations of incidents at refineries;

  - review certification filings, status and incident reports, and analyze performance data of refineries in an effort to ensure that refineries are appropriately maintained and efficiently operated, and that refinery production is reliable and adequate; and

  - monitor and analyze market data to detect the presence of market manipulation by the oil industry through refinery outages.

- The regulation of refineries to prevent economic manipulation would be a very complex job, and in reality, is an entirely different undertaking than the oversight of power plant production.

    - While power plants are highly complex, they have essentially one product: electricity. Refineries have dozens of refined products and switch their refining capacity between those products for economic reasons.

    - Electricity can not be stored, but must be produced in real time. Gasoline storage and inventory most likely have major impacts on the interplay of refinery production and gasoline prices.

    - The entire electric system is closely regulated by the CPUC and the ISO, as well as FERC. There seems to be relatively little regulatory oversight of the oil refining industry beyond state environmental requirements.

PROGRAM BACKGROUND:

- The Commission issued GO 167 pursuant to SB xx 39 (Chapter 19, Statutes of 2001-02 Second Extraordinary Session), which authorized the CPUC to implement and enforce standards for maintenance and operation of electric generation facilities to ensure their reliable operation.

- GO 167 established the Electric Generation Performance Branch (EGPB) and tasked it with operation and maintenance audits, outage inspections and investigations of incidents at electric generation facilities. EGPB also reviews certification filings, status and incident reports, and analyzes performance data of power plants in an effort to ensure that the generating facilities are appropriately maintained and operated, and that electrical service to the customers is reliable and adequate.

- There are 208 power plants under CPUC jurisdiction, most of which are smaller than 50 megawatts. EGPB inspects, audits and investigates only those plants that are 50 megawatts or larger, which includes about 44 plants that comprise roughly half of the state's generation capacity.

- EGPB monitors power plants in three different ways:

    - OUTAGE INSPECTIONS: Whenever a plant's capacity is reduced by 50 mw or more, EGPB inspects the plant, generally in person, but sometimes through a telephone interview. When EGPB receives notice of such an outage, it inspects within a day, and follows up as long as the outage continues (once a week for forced outages; once a month for planned outages). Numbers of outages vary year to year, but there are generally several hundred of them.

- AUDITS: EGPB audits two to four power plants a year. These audits are extensive, and include a week-long visit to the plant by a team of four to six engineers.

- INVESTIGATIONS: From time to time, EGPB takes a deeper look at individual plants or outages for example when plants announce an intention to shut down or after Stage Emergencies. EGPB has only conducted a few of these investigations due to a lack of staff.

- In general, EGPB inspects all plant outages 50 mw or greater. In choosing which plants to audit first, several competing considerations are balanced:
    1) how many outages did the plant have during peak periods;
    2) how important is the plant to the electric system;
    3) has the plant been inspected or audited on a regular basis; and
    4) has a random audit been performed to detect deferred maintenance?

- In all inspections, EGPB asks for evidence of the cause of any mechanical shutdowns. In the nearly all cases, the claimed cause of failure appears to be accurate. EGPB also asks for copies of root cause analyses performed by the plants for these outages.

- On the other hand, some of these mechanical shutdowns, however real, could have been prevented by better maintenance, operation, and other practices over time. EGPB conducts detailed audits of plants to make sure that they have comprehensive maintenance and operation programs, and pays special attention to parts of the plants that have failed and caused outages.

LEGISLATIVE HISTORY:

Not applicable.

FISCAL IMPACT ON CPUC:

Based solely on Senator Dunn's expressed intent that the CPUC regulate the performance of oil refineries through inspections and investigations, CPUC staff has taken the liberty of loosely equating such regulatory activity with the activity of the Electric Generation Performance Branch (EGPB) in order to develop this fiscal estimate. Based on EGPB start-up costs and annual costs, CPUC staff conservatively estimates that a refinery division would cost approximately $2.5 million in the first year and $2 million thereafter.

STATUS: This bill passed the Senate Energy, Utilities and Communications Committee on a vote of 6 to 2, and is now awaiting a hearing by the Senate Appropriations Committee.

SUPPORT/OPPOSITION:

Support: Unknown.

Opposition: Western States Petroleum Association.

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Date: April 27, 2006

BILL LANGUAGE:

BILL NUMBER: SB 1794 AMENDED
BILL TEXT

AMENDED IN SENATE APRIL 18, 2006

INTRODUCED BY Senators Dunn and Kehoe

FEBRUARY 24, 2006

An act to amend Section 216 of, and to add Sections 230.1 ~~and 230.2~~ *, 230.2, and 731* to, the Public Utilities Code, relating to public utilities.

LEGISLATIVE COUNSEL'S DIGEST

SB 1794, as amended, Dunn Public utilities: refineries.

(1) The California Constitution establishes the Public Utilities Commission, with jurisdiction over all public utilities, as defined. The California Constitution authorizes the Legislature to prescribe that additional classes of private corporations or other persons are public utilities. Under the existing Public Utilities Act, a public utility has a duty to serve, including furnishing and maintaining adequate, efficient, just and reasonable service, instrumentalities, equipment, and facilities as are necessary to promote the safety, health, comfort, and convenience of its patrons and the public.

This bill would make a refinery corporation, as defined, a public utility for purposes of the act. *The bill would provide that the commission's regulatory authority over a refinery, as defined, and a refinery corporation does not include the authority to establish rates for refinery products.*

(2) Under existing law, a violation of any provision of the Public Utilities Act or of any of the rules or orders issued by the commission, is a crime.

Because the provisions of this bill would be a part of the act and because a violation of an order or decision of the commission relative to a refinery corporation would be a crime, the bill would impose a state-mandated local program by creating a new crime.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: yes.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature finds and declares all of the following:

(a) Gasoline and other refined petroleum products are basic necessities for California's residents and businesses.

(b) High prices for gasoline and other refined petroleum products harm California residents and the economy.

(c) The California Constitution provides that private persons and corporations that own, operate, control, or manage a line, plant, or system for furnishing heat, light, and power directly or indirectly to or for the public, are public utilities, and that the Legislature may prescribe that additional classes of private corporations or other persons are public utilities.

(d) Persons and corporations that own, control, operate, or manage oil refineries in California are public utilities, and it is in the public interest for the Public Utilities Commission to regulate oil refineries.

SEC. 2. Section 216 of the Public Utilities Code is amended to read:

216. (a) "Public utility" includes every common carrier, toll bridge corporation, pipeline corporation, refinery corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, sewer system corporation, and heat corporation, where the service is performed for, or the commodity is delivered to, the public or any portion thereof.

(b) Whenever any common carrier, toll bridge corporation, pipeline corporation, refinery corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, sewer system corporation, or heat corporation performs a service for, or delivers a commodity to, the public or any portion thereof for which any compensation or payment whatsoever is received, that common carrier, toll bridge corporation, pipeline corporation, refinery corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, sewer system corporation, or heat corporation, is a public utility subject to the jurisdiction, control, and regulation of the commission and the provisions of this part.

(c) When any person or corporation performs any service for, or delivers any commodity to, any person, private corporation, municipality, or other political subdivision of the state, that in turn either directly or indirectly, mediately or immediately, performs that service for, or delivers that commodity to, the public or any portion thereof, that person or corporation is a public utility subject to the jurisdiction, control, and regulation of the commission and the provisions of this part.

(d) Ownership or operation of a facility that employs cogeneration technology or produces electricity from other than a conventional power source or the ownership or operation of a facility which employs landfill gas technology does not make a corporation or person a public utility within the meaning of this section solely because of the ownership or operation of that facility.

(e) Any corporation or person engaged directly or indirectly in developing, producing, transmitting, distributing, delivering, or selling any form of heat derived from geothermal or solar resources or from cogeneration technology to any privately owned or publicly owned public utility, or to the public or any portion thereof, is not a public utility within the meaning of this section solely by reason of engaging in any of those activities.

(f) The ownership or operation of a facility that sells compressed natural gas at retail to the public for use only as a motor vehicle fuel, and the selling of compressed natural gas at retail from that facility to the public for use only as a motor vehicle fuel, does not make the corporation or person a public utility within the meaning of this section solely because of that ownership, operation, or sale.

(g) Ownership or operation of a facility that has been certified by the Federal Energy Regulatory Commission as an exempt wholesale generator pursuant to Section 32 of the Public Utility Holding Company Act of 1935 (Chapter 2C (commencing with Section 79) of Title 15 of the United States Code) does not make a corporation or person a public utility within the meaning of this section, solely due to the ownership or operation of that facility.

(h) The ownership, control, operation, or management of an electric plant used for direct transactions or participation directly or indirectly in direct transactions, as permitted by subdivision (b) of Section 365, sales into the Power Exchange referred to in Section 365, or the use or sale as permitted under subdivisions (b) to (d), inclusive, of Section 218, shall not make a corporation or person a public utility within the meaning of this section solely because of that ownership, participation, or sale.

SEC. 3. Section 230.1 is added to the Public Utilities Code, to read:

230.1. "Refinery corporation" includes every corporation or person owning, controlling, operating, or managing any refinery for compensation within this state.

SEC. 4. Section 230.2 is added to the Public Utilities Code, to read:

230.2. "Refinery" means any plant or facility, regardless of capacity, for the processing of crude oil feedstock or the manufacturing of oil products, for sale to or use by the public.

SEC. 5. Section 731 is added to the Public Utilities Code , to read:

731. The commission's regulatory authority over a refinery and a refinery corporation does not include the authority to establish rates for refinery products.

~~SEC. 5.~~ *SEC. 6.* No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

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